PD6 Exh 7

The Business Case for Ethics and Compliance - Convincing the CFO in Difficult Economic Times

Association of Corporate Counsel

CORPORATE LAW LEADERSHIP FORUM

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Essential to care™

Overview

- Traditional support for an Ethics and Compliance program
  - Legal/Quasi-legal standards
  - Liabilities for noncompliance
- Strategic benefits of an ethics and compliance program

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Why invest in establishing an ethics and compliance program?

Traditional View

- Prevent and detect noncompliance/wrongdoing
  - Employees know and understand their obligations
  - Employees report wrongdoing without fear of retaliation
- Prevent prosecution of the company
  - Principles of Federal Prosecution of Business Organizations
- Mitigate fines imposed on the company
  - Federal Sentencing Guidelines for Organizations

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Why invest in establishing an ethics and compliance program?

Strategic

- ***An effective Ethics and Compliance program is a business enabler and can provide a company with a sustainable strategic advantage in the marketplace***

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Convincing the CFO

- Avoids disruption to business due to administrative, civil or criminal investigations
- Reduces potential for corporate and/or personal liability
- Enhances reputation and yields economic benefits
  - Increases employee retention and engagement
  - Increases customer loyalty
  - Increases investor confidence and trust
- It is the right thing to do
- Bottom Line: good for business; critical for survival

Better to be Tylenol than peanut butter!

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Legal/Quasi-legal requirements

- Federal Sentencing Guidelines for Organizations
- Principles of Federal Prosecution of Business Organizations
- HHS Office of Inspector General Model Compliance Guidance
- Sarbanes-Oxley Act of 2002
- Federal Acquisition Regulations
- NYSE Listed Company Manual

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Corporate and individual liability

- Selling your CFO on the importance of investing in, and implementing an effective ethics and compliance program should include a discussion of:
  – Corporate liability
  – Individual liability

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Corporate liability

- **Morgan Stanley**
  - Insider Trading = $10 million
- **Schering Plough**
  - Illegal Drug Marketing and Pricing = $435 million
- **Eli Lilly**
  - Off-label promotion of Zyprexa = $1.4 billion
- **Pfizer**
  - Off-label promotion of Bextra= $2.3 billion

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Caremark – director liability

- *In re Caremark International Inc. Derivative Litigation,* 698 A.2d 959 (Del Ch. 1996).
  - This case is best known and cited for its expansion of a director's duty of oversight. According to *Caremark*, directors may be liable for losses caused by non-compliance with applicable legal standards. However, an effective ethics and compliance program is an important mitigation factor in case of prosecution.

The Park Doctrine – individual liability

- *United States v. Park* (1975)
  - US Supreme Court held that individuals who have authority to prevent violations of law can be held vicariously liable for the illegal acts of subordinates or agents
  - Responsible corporate officers have an affirmative duty to seek out and remedy violations and implement measures to prevent violations
  - Failure to exercise proper care in carrying out duties creates liability
  - Delegation to subordinates does not negate liability

Who is a responsible corporate officer?

- Anyone with authority to prevent or correct violations
- Most often:
  - Highest ranking corporate officer (*e.g.*, CEO, CFO, president, etc.)
  - Executive with direct authority to implement corrective actions (*e.g.*, director of regulatory affairs or director of corporate compliance)

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Recent cases of individual liability

- **AbTox (2006)**
  - Two executives received ten-year and six-year prison sentences, respectively, for felony violations of the Federal Food, Drug and Cosmetic Act (FFDCA) relating to the introduction of adulterated and misbranded sterilizers into interstate commerce
  - Ordered to pay over $17 million in restitution
  - Sentences were affirmed, but restitution order vacated by US Court of Appeals for 7th Cir (2008)
- **Purdue Pharma (2007)**
  - Company and three executives pleaded guilty to misdemeanor FFDCA violations relating to the promotion and marketing of the painkiller OxyContin
  - Company agreed to pay $634.5 million in fines
- **Advanced Bionics (2008)**
  - Company and executive agreed to pay civil money penalties of $1.1 million and $75,000, respectively, for FFDCA violations relating to failure to comply with 510(k) requirements relating to Cochlear Implants
- **InterMune (2008)**
  - Former executive indicted for wire fraud and felony FFDCA violations relating to the promotion and marketing of Actimmune
  - In 2006, Company agreed to pay more than $36.9 million to resolve related criminal charges

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Compliance spending reduces liability, affording positive returns

Benefits

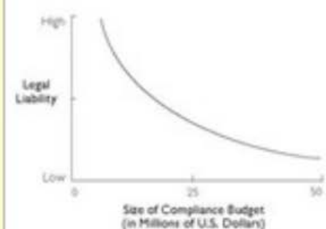
- Enhance Shareholder Value
  - Efficiency gains through adoption of standard policy process
  - Cost avoidance and reputation protection through formal compliance education program
  - Early issue identification and consistent policy enforcement via business conduct line and electronic case management
  - Risk reduction through monitoring of risk owners
  - OSG mitigation
  - Position leverage

Source: General Counsel Roundtable

Overview of Data Driver

Roundtable data analysis reveals companies can substantially reduce legal liability by increasing investment in compliance; this finding is even more compelling once the indirect ramifications of compliance failures (such as reputational harm and lost productivity) are included in ROI calculations.

Relationship Between Compliance Spending and Damages, Settlements, and Fines[1]



n = 73.

As a company increases compliance spending, legal liability decreases. Each additional dollar of compliance spending reduces damages, settlements, and fines, on average, by $1.37.

Additional Savings per Dollar Increase in Compliance Spending[2]

Decrease in Damages, Settlements, and Fines		$1.37
Avoidance of Reputational Harm[3]		$2.74
Avoidance of Lost Productivity[3]		$1.10
Total Savings		**$5.21**
Increase in Compliance Budget		**$1.00**
ROI	$5.21/$1.00 – 1 =	**421%**

When the indirect ramifications of compliance failures—such as reputational harm and lost productivity—are included, the returns from compliance spending exceed 400%.

Universal Opportunity for Improvement

Benchmarking data analysis reveals even the most progressive departments spend less than half the optimal amount on compliance.

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Increased Employee Retention and Engagement

- Companies that have a strong foundation of ethical conduct have a more loyal employee base, less turnover and higher productivity

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Increased Customer Loyalty

- Studies support that companies with a strong commitment to ethics and compliance financially outperform companies that do not:
  - Institute of Business Ethics – U.K. studied two groups of companies for the years 1997-2001 and concluded that the group of companies with an explicit commitment to doing business ethically had produced a profit ratio 18% higher than the group without a similar commitment

Increased Shareholder Loyalty

- Corporate Responsibility Officer Association 100 Best Corporate Citizens 2009
  - Analysis of publicly available information on corporate responsibility
  - Comparison of companies that have appeared on the list within the last nine years
    - Companies outpaced the rest of the Russell 1000® in three year total return by 26 percent
    - Provides meaningful protection from downside stock risk
- A 2005 study by Russell Investment Group: "Fortune Magazine's 100 Best Companies to work for in America" earned over four times the return of the broader market over seven years (60% of the criteria was based on trust). (Cited in The Speed of Trust by Stephen Covey).

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The right thing to do: Setting Tone at the Top

- *"Mere knowledge of the rules is not enough. Organizations must take affirmative steps to create an environment where doing the right thing is the norm and the standard."*[1]
- *"It's got to start at the top….If we've learned anything from this current round of revelations, it's that if the people at the top aren't committed to integrity, if they don't live their own values and the values of the company, there is no hope."*[2]

[1] *Source: "How Changes to Federal Sentencing Guidelines Will Affect Ethics and Compliance By: David Gerber*

[2] *Shelly Lazarus as quoted in "The Integrity Advantage" by Adrian Gostick and Dana Telford*

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Q&A

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Thank you!

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